

**ST 01-16**  
**Tax Type:** Sales Tax  
**Issue:** Machinery and Equipment Exemption – Manufacturing

**DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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**DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

**v.**

**ABC Company,  
Taxpayer**

**No. 00-ST-0000  
IBT No. 0000-0000  
Tentative Claim Denial 3/27/00**

**Charles E. McClellan  
Administrative Law Judge**

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**RECOMMENDATION FOR DECISION**

**Appearances:**

John D. Alshuler, Special Assistant Attorney General, for the Department. Paul M. Chernawsky, of Parrillo & Chernawsky, for the taxpayer.

**Synopsis:**

This matter arose from a timely filed protest to a Notice of Tentative Denial of Claim for credit filed by ABC Company (taxpayer) for use tax<sup>1</sup> paid in connection with the taxpayer's purchase of computer equipment between June 8, 1995 and November 20, 1995. The computer equipment is used by the taxpayer for computer assisted design work in connection with its business of manufacturing special order machinery and equipment. An evidentiary hearing was held on June 28, 2001. I recommend that the Notice of Tentative Denial be made final.

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<sup>1</sup> The "use tax" is the tax imposed by the Use Tax Act. (UTA), 35 ILCS 105/1, *et seq.*, commonly referred to as the "use tax".

**Findings of Fact:**

1. Taxpayer is a corporation engaged in the business of designing and manufacturing special order machinery and equipment. Tr. p. 9.
2. The computer equipment involved in this matter consists of ten computers, each computer consisting of a central processing unit, a keyboard, a monitor and a mouse. Tr. pp. 11-12, Taxpayer Ex. No. 1.
3. These computers are loaded with a computer assisted design (CAD) software program named DRAWING that is used to produce schematic drawings, similar to blue prints, of the components of the machines that the taxpayer manufactures for its customers. Tr. pp. 15-19, Taxpayer Group Ex. No. 2.
4. The schematic drawings present detailed drawings of the systems that are manufactured and assembled to make the special order machines ordered by the taxpayer's customers. *Id.*
5. The schematic drawings are printed by the laser printers attached to the computers. *Id.*
6. For each machine order, schematic drawings of its components are made and then given to the taxpayer's manufacturing and assembly department personnel to direct them on how to set up the manufacturing machines to make and assemble the electrical, pneumatic and hydraulic systems for the machine being manufactured. *Id.*
7. Taxpayer utilizes mills and lathes to manufacture the machines it designs for its customers. Tr. p. 26.
8. There is no electronic connection between the computers involved in this case and the mills and lathes used in taxpayer's manufacturing process. Tr. pp. 26-27.

**Conclusions of Law:**

The issue in this case is whether the computers are exempt from use tax under the manufacturing and assembly exemption set forth in the use tax statute. The statute provides an exemption for machinery and equipment purchased for use in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. 35 ILCS 105/3-5(18). As used in the statute, the terms "machinery" and "equipment" are defined as follows:

“Machinery” means major mechanical machines or major components of those machines contributing to a manufacturing or assembling process.

35 ILCS 105/2-50(3)

“Equipment” includes an independent device or tool separate from machinery but essential to an integrated manufacturing or assembly process; including computers used primarily in operating exempt machinery and equipment in a computer assisted design, computer assisted manufacturing (CAD/CAM) system; . . .

35 ILCS 105/2-50(4)

The Department’s regulation, at 86 Ill. Admin. Code § 130.330<sup>2</sup>, provides as follows:

b) Manufacturing and Assembling.

1) This exemption exempts from tax only machinery and equipment used in manufacturing or assembling tangible personal property for sale or lease. Thus, the use of machinery and equipment in any industrial, commercial or business activity which may be distinguished from manufacturing or assembling will not be an exempt use and such machinery and equipment will be subject to tax.

2) The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant.

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c) Machinery and Equipment

1) The law exempts only the purchase and use of "machinery" and "equipment" used in manufacturing or assembling. Accordingly, no other type or kind of tangible personal property will qualify for the exemption, even though it may be used primarily in the manufacturing or assembling of tangible personal property for sale or lease.

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<sup>2</sup> This regulation was promulgated under the Retailers’ Occupation Tax Act and made applicable to the Use Tax Act by adoption in the Use Tax Act regulations. 86 Admin Code ch. I, § 150.1201.

- 2) Equipment includes any independent device or tool separate from any machinery but essential to an integrated manufacturing or assembling process: including computers used primarily in operating exempt machinery and equipment in a computer-assisted design, computer-assisted manufacturing (CAD/CAM) system; . . . .

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d) Primary Use

- 1) The law requires that machinery and equipment be used primarily in manufacturing or assembling. . . .
- 3) The fact that particular machinery or equipment may be considered essential to the conduct of the business of manufacturing or assembling because its use is required by law or practical necessity does not, of itself, mean that machinery or equipment is used primarily in manufacturing or assembling.  
86 Ill. Admin. Code § 130.330.

In a case involving a statutory tax exemption the rules of statutory construction require that the relevant statutory provisions be strictly construed in favor of taxation. Chicago Bar Ass'n v. Dept. of Revenue, 163 Ill.2d 290, 644 N.E.2d 1166 (1994); Board of Certified Safety Professionals of America, Inc. v. Johnson, 112 Ill.2d 542, 494 N.E.2d 485, (1986); Richard's Tire Co. v. Zender, 295 Ill.App.3d 48, 692 N.E.2d 360 (2d Dist. 1998). The taxpayer seeking the exemption must prove clearly and conclusively that it is entitled to it. See Chicago Bar Ass'n, 163 Ill. 2d at 300, 644 N.E. 2d at 1171; Board of Certified Safety Professionals of Americas, Inc. v. Johnson, 112 Ill.2d at 547, 494 N.E.2d at 488; United Airlines v. Johnson, 84 Ill.2d 446, 455, 419 N.E.2d 899, 904 (1981).

All facts and debatable questions must be construed in favor of taxation. Wyndemere Retirement Community v. Department of Revenue, 274 Ill. App.3d 455, 459, 654 N.E.2d 608, 611 (2<sup>nd</sup> Dist. 1995); XL Disposal Corporation, Inc. v. Department of Revenue, 304 Ill. App. 3d 202, 709 N.E.2d 293 (4th Dist. 1999). The taxpayer in the instant case is claiming a statutory exemption, so these are the procedural rules that apply to this matter.

The language in the statute providing for the exemption and the Department's regulation make it clear that the exemption requires that the computers at issue operate exempt machinery and equipment or that they be used in or are integral to the process of manufacturing or assembling tangible personal property for sale or lease. The computers in

this case are used to produce schematic drawings of the machines to be produced on milling machines and lathes. The design of the machines on the computers is an activity that is distinct from the manufacture of the machines on the milling machines and lathes. The computers do not operate exempt machinery nor do they produce tangible personal property for sale or lease. Therefore, the computers do not come within the statutory language for exemption.

Taxpayer argues that these machines are essential elements of its business. Assuming *arguendo* that taxpayer's argument is true, the design activity for which they are used is distinct from the manufacturing activity for which their output, the schematic drawings, is used. Taxpayer's witness admitted that the computers in question are not connected to the manufacturing machines. This testimony establishes that the computers do not operate machines that do exempt manufacturing. Accordingly, although they may be essential to taxpayer's business, they are not essential or integral to the manufacturing process within the meaning of the statute.

The Department's regulation cited above specifically addresses the type of situation in which an item of equipment is considered to be essential or necessary to the conduct of a manufacturing business but is not used directly in a manufacturing process. The regulation provides that the item does not qualify because it is not used primarily in manufacturing or assembling even though it is essential to the business. That is the situation in this case. The taxpayer's witness views the computers at issue as being essential to its business, but that alone does not qualify them for the exemption. The computers produce schematic drawings. They do not manufacture any tangible personal property for sale or lease. Therefore, the computers do not qualify for the exemption.

Taxpayer has failed to introduce any credible, relevant evidence sufficient to overcome the Department's *prima facie* case. Therefore, for the reasons stated above, I recommend that the Notice of Tentative Claim Denial be made final.

**ENTER: July 30, 2001**

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**Administrative Law Judge**